Tennessee Valley Authority

(Wholly Owned Corporate Agency and Instrumentality of the United States of America)

Quarterly Report

For the quarterly period ended December 31, 2003

Tennessee Valley Authority

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For the quarterly period ended December 31, 2003

This document contains the unaudited Quarterly Report of TVA's Power Program and All Programs for the quarterly period ended December 31, 2003 (this "Quarterly Report"). TVA is not required to register securities under the Securities Act of 1933 or to make periodic reports to the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934. Accordingly, TVA does not intend to file this report with the SEC. In addition, several portions of this Quarterly Report contain forward-looking statements, and reference is made to page one regarding such statements. This report should be read in conjunction with the 2003 Information Statement dated as of February 4, 2004 (as may be amended from time to time, the "2003 Information Statement").

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Forward-Looking Statements

This Quarterly Report contains forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions, assumptions, or otherwise relating to future events or performance may be forward-looking.

In certain cases, forward-looking statements can be identified by the use of words such as “may,” “will,” “should,” “expect,” “anticipate,” “believe,” “intend,” “project,” “plan,” “predict,” “assume,” “estimate,” “objective,” “possible,” “potential,” or other similar expressions.

Some examples of forward-looking statements include statements regarding TVA’s projections of future power and energy requirements; future costs related to environmental compliance; impacts of potential legislation on TVA and the likelihood of enactment of such legislation; strategic objectives; anticipated availability of nuclear waste storage facilities; projections of nuclear decommissioning costs; and impacts of pending litigation and various administrative orders which have been or may be issued.

Although TVA believes that the assumptions underlying the forward-looking statements are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things, new laws, regulations, and administrative orders, especially those related to restructuring of the electric power industry and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial and economic environment; performance of TVA’s generation and transmission assets; fuel prices; demand for electricity; changes in technology; changes in the price of power; loss of any significant customers or suppliers; creditworthiness of counterparties; weather conditions and other natural phenomena; changes in accounting standards; and unforeseeable events. New factors emerge from time to time, and it is not possible for management to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA’s business or cause results to differ materially from those contained in any forward-looking statement.

TVA undertakes no obligation to update any forward-looking statement to reflect developments that occur or come to TVA’s attention after the statement is made.

FINANCIAL INFORMATION

STATEMENTS OF INCOME–POWER PROGRAM (unaudited)
For the three months ended December 31
(in millions)

	2003	2002
Operating revenues		
Sales of electricity		
Municipalities and cooperatives	$ 1,521	$ 1,446
Industries directly served	198	186
Federal agencies and other	37	31
Other revenue	21	19
Total operating revenues	1,777	1,682
Operating expenses		
Fuel and purchased power	430	409
Operating and maintenance	556	488
Depreciation and accretion	272	263
Tax-equivalents	84	82
Loss on project cancellation (see note 1)	36	–
Total operating expenses	1,378	1,242
Operating income	399	440
Other income, net	4	3
Interest expense		
Interest on debt	348	353
Amortization of debt discount, issue, and reacquisition costs, net	7	8
Allowance for funds used during construction	(22)	(15)
Net interest expense	333	346
Income before cumulative effects of accounting changes	70	97
Cumulative effect of change in accounting for unbilled revenue	–	412
Cumulative effect of change in accounting for asset retirement obligations	–	(195)
Net income	$ 70	$ 314

The accompanying notes are an integral part of these financial statements.

BALANCE SHEETS—POWER PROGRAM AND ALL PROGRAMS (unaudited)
(in millions)

	Power Program		All Programs	
ASSETS	**December 31 2003**	**September 30 2003**	**December 31 2003**	**September 30 2003**
Current assets				
Cash and cash equivalents	$ 276	$ 532	$ 277	$ 533
Accounts receivable, net	958	994	958	994
Inventories at average cost and other				
Fuel	215	219	215	219
Other, net	299	308	299	308
Total current assets	1,748	2,053	1,749	2,054
Property, plant, and equipment				
Completed plant	32,752	32,626	33,762	33,637
Less accumulated depreciation	(12,483)	(12,251)	(12,802)	(12,568)
Net completed plant	20,269	20,375	20,960	21,069
Construction in progress	1,805	1,619	1,805	1,619
Deferred nuclear generating units	4,111	4,110	4,111	4,110
Nuclear fuel and capital leases	497	530	497	530
Total property, plant, and equipment	26,682	26,634	27,373	27,328
Investment funds	983	905	983	905
Deferred charges and other assets				
Loans and other long-term receivables	168	168	191	191
Debt issue and reacquisition costs	238	241	238	241
Other deferred charges	680	531	680	531
Regulatory assets	1,818	1,861	1,818	1,861
Total deferred charges and other assets	2,904	2,801	2,927	2,824
Total assets	$ 32,317	$ 32,393	$ 33,032	$ 33,111
LIABILITIES AND PROPRIETARY CAPITAL				
Current liabilities				
Accounts payable	$ 606	$ 776	$ 607	$ 777
Accrued liabilities	178	232	178	232
Current portion of lease/leaseback obligations	66	68	66	68
Current portion of energy prepayment obligations	106	5	106	5
Accrued interest	328	404	328	404
Short-term debt	896	2,080	896	2,080
Current maturities of long-term debt	1,936	2,336	1,936	2,336
Total current liabilities	4,116	5,901	4,117	5,902
Other liabilities				
Deferred liabilities	2,143	2,177	2,143	2,177
Asset retirement obligations	1,749	1,725	1,749	1,725
Lease/leaseback obligations	1,170	1,170	1,170	1,170
Energy prepayment obligations (see note 1)	1,428	42	1,428	42
Total other liabilities	6,490	5,114	6,490	5,114
Long-term debt				
Public bonds	20,539	20,459	20,539	20,459
Unamortized discount and other adjustments	(80)	(258)	(80)	(258)
Total long-term debt	20,459	20,201	20,459	20,201
Commitments and contingencies (see note 5)				
Proprietary capital				
Appropriation investment	463	468	4,818	4,823
Retained earnings	848	783	848	783
Accumulated other comprehensive loss	(59)	(74)	(59)	(74)
Accumulated net expense of nonpower programs	–	–	(3,641)	(3,638)
Total proprietary capital	1,252	1,177	1,966	1,894
Total liabilities and proprietary capital	$ 32,317	$ 32,393	$ 33,032	$ 33,111

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CASH FLOWS—POWER PROGRAM (unaudited)
For the three months ended December 31
(in millions)

	2003	2002
Cash flows from operating activities		
Net power income	$ 70	$ 314
Items not requiring (providing) cash		
Depreciation, amortization, and accretion	290	287
Allowance for funds used during construction	(22)	(15)
Nuclear fuel amortization	31	35
Cumulative effect of accounting changes	–	(217)
Loss on project cancellation	36	–
Other, net	37	20
Changes in current assets and liabilities		
Accounts receivable	36	151
Inventories and other	7	(21)
Accounts payable and accrued liabilities	(211)	(197)
Accrued interest	(80)	(96)
Proceeds from energy prepayments	1,504	32
Other	(63)	(15)
Net cash provided by operating activities	1,635	278
Cash flows from investing activities		
Construction expenditures	(388)	(399)
Allowance for funds used during construction	22	15
Nuclear fuel	(1)	(69)
Other, net	(4)	(6)
Net cash used in investing activities	(371)	(459)
Cash flows from financing activities		
Long-term debt		
Issues	93	156
Redemptions and repurchases	(415)	–
Short-term redemptions, net	(1,184)	(260)
Proceeds from combustion turbine financing	–	163
Payments on lease/leaseback financing	(3)	(11)
Financing costs, net	(1)	(3)
Payments to U.S. Treasury	(10)	(10)
Net cash (used in)/provided by financing activities	(1,520)	35
Net change in cash and cash equivalents	(256)	(146)
Cash and cash equivalents at beginning of period	532	397
Cash and cash equivalents at end of period	$ 276	$ 251

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CASH FLOWS—ALL PROGRAMS (unaudited)
Three months ended December 31
(in millions)

	2003	2002
Cash flows from operating activities		
Net power income	$ 70	$ 314
Net expense of nonpower programs	(3)	(3)
Items not requiring (providing) cash		
Depreciation, amortization, and accretion	293	289
Allowance for funds used during construction	(22)	(15)
Nuclear fuel amortization	31	35
Cumulative effect of accounting changes	–	(217)
Loss on project cancellation	36	–
Other, net	37	20
Changes in current assets and liabilities		
Accounts receivable	36	151
Inventories and other	7	(21)
Accounts payable and accrued liabilities	(211)	(197)
Accrued interest	(80)	(96)
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Financing costs, net	(1)	(3)
Payments to U.S. Treasury	(10)	(10)
Net cash (used in)/provided by financing activities	(1,520)	35
Net change in cash and cash equivalents	(256)	(147)
Cash and cash equivalents at beginning of period	533	400
Cash and cash equivalents at end of period	$ 277	$ 253

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL—POWER PROGRAM (unaudited)
Three months ended December 31
(in millions)

	2003	2002
Retained earnings reinvested at beginning of period	$ 783	$ 349
Net income	70	314
Return on appropriation investment	(5)	(5)
Retained earnings reinvested at end of period	848	658
Accumulated other comprehensive (loss) at beginning of period	(74)	(150)
Other comprehensive income/(loss)	15	(74)
Accumulated other comprehensive (loss) at end of period	(59)	(224)
Appropriation investment at beginning of period	468	488
Return of appropriation investment	(5)	(5)
Appropriation investment at end of period	463	483
Proprietary capital at end of period	$ 1,252	$ 917

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL—NONPOWER PROGRAMS (unaudited)
Three months ended December 31
(in millions)

	2003	2002
Proprietary capital at beginning of period	$ 717	$ 729
Net expense	(3)	(3)
Proprietary capital at end of period	$ 714	$ 726

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF COMPREHENSIVE INCOME—POWER PROGRAM (unaudited)
Three months ended December 31
(in millions)

	2003	2002
Net power income	$ 70	$ 314
Other comprehensive income/(loss)	15	(74)
Comprehensive income	$ 85	$ 240

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF NET EXPENSE AND COMPREHENSIVE LOSS—NONPOWER PROGRAMS (unaudited)
Three months ended December 31
(in millions)

	2003	2002
Water and land stewardship	$ 3	$ 3
Other comprehensive loss	–	–
Net expense and comprehensive loss	$ 3	$ 3

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS (unaudited)

1. Summary of Significant Accounting Policies

Organization
TVA is a wholly owned corporate agency and instrumentality of the United States. It was established by Congress in 1933 by the TVA Act with the objective of developing the resources of the Tennessee Valley region in order to strengthen the regional and national economy and the national defense by providing: (1) an ample supply of power within the region, (2) navigable channels and flood control for the Tennessee River System, and (3) agricultural and industrial development and improved forestry in the region. TVA carries out these regional and national responsibilities in a service area that includes most of Tennessee, northern Alabama, northeastern Mississippi, southwestern Kentucky, and small portions of Georgia, North Carolina, and Virginia.

Substantially all TVA revenues and assets are attributable to its power program. The revenues and expenses of the power program have historically been segregated and distinct from TVA's nonpower programs. The TVA Act requires the power program to be self-supporting from power revenues and proceeds from power program financings.

Power rates are established by the TVA Board of Directors ("Board") as authorized by the TVA Act. The TVA Act requires TVA to charge rates for power that, among other things, will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to states and counties in lieu of taxes; debt service on outstanding indebtedness; and annual payments to the U.S. Treasury in repayment of and as a return on the government's appropriation investment in TVA's power facilities. Rates set by the Board are not subject to review or approval by any state or federal regulatory body. In a future restructured electric power industry, it is possible, however, that the ability of the Board to set TVA's rates as specified in the TVA Act could be adversely affected by legislative changes or by competitive pressures.

Basis of Presentation
TVA prepares its interim financial statements in conformity with generally accepted accounting principles accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Because the accompanying interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements, they should be read in conjunction with the audited financial statements for the period ended September 30, 2003 and the notes thereto.

The amounts included in the interim financial statements are unaudited but, in the opinion of management, reflect all adjustments necessary to fairly present TVA's financial position and results of operations for the interim periods. Due to seasonal weather variations and the timing of planned maintenance and refueling outages of electric generating units and other factors, the results of operations for interim periods are not necessarily indicative of amounts expected for the entire year.

In preparing financial statements that conform to generally accepted accounting principles, management must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenues and expenses. Actual results could differ from those estimates.

Fiscal Year
TVA's fiscal year ends September 30. Unless otherwise indicated, years (2004, 2003, etc) refer to TVA's fiscal years.

Accounts Receivable
Accounts receivable primarily consist of amounts due from power sales. The table below summarizes the type and amount of receivables:

	At December 31 2003	At September 30 2003
	(in millions)	
Power receivables billed	$ 220	$ 304
Power receivables unbilled	700	655
Total power receivables	920	959
Other receivables	45	43
Allowance for uncollectible accounts	(7)	(8)
Net accounts receivable	$ 958	$ 994

Regulatory Assets

Regulatory assets represent costs capitalized under the provisions of Statement of Financial Accounting Standards ("SFAS") No. 71, *Accounting for the Effects of Certain Types of Regulation*. TVA's regulatory assets consist of certain charges related to the closure and removal of nuclear generating units, mark-to-market valuation adjustments of derivative contracts, and an adjustment related to minimum pension liability. TVA's regulatory assets consisted of the following:

	At December 31 2003	At September 30 2003
	(in millions)	
Decommissioning costs	$ 729	$ 783
Changes in fair value of derivative contracts	61	50
Adjustment to accrue minimum pension liability	1,028	1,028
Total	$ 1,818	$ 1,861

Energy Prepayment Obligations

During October of 2002, TVA introduced an energy prepayment program, Discounted Energy Units ("DEU") program, as another way of providing value to its customers. Annually for years 2003 to 2007, TVA customers may purchase DEU in $1 million increments, which entitles them to a 0.025 $/kWh discount on a specified quantity of firm load over a period of years (10, 15, or 20) for each kilowatt-hour in the prepaid block. The remainder of the price of the kilowatt-hours delivered is due upon billing. This program allows customers to use the DEU to reduce their overall costs and provides a higher return for available cash.

As of December 31, 2003, TVA had entered into sales agreements for 47.25 DEU totaling $47.25 million for the 2003 program and sales agreements of 7.25 DEU totaling $7.25 million for the 2004 program. TVA is accounting for the prepaid power as unearned revenue in Energy prepayment obligations on the December 31, 2003, Balance Sheets and is recognizing revenue as electricity is delivered to customers, based on the ratio of units of kilowatt-hours delivered to total units of kilowatt-hours under contract. As of December 31, 2003, nearly $5 million has been applied against power billings, of which $1.3 million is attributable to 2004 activity.

TVA and its largest customer, Memphis Light, Gas & Water ("MLGW") entered into an energy prepayment agreement under which MLGW prepaid TVA $1.5 billion for the costs of electricity to be delivered by TVA to MLGW over a period of 180 months. In exchange for this prepayment, MLGW receives a credit on its monthly bills during this period. The City of Memphis issued bonds with net proceeds of $1.5 billion, the proceeds of which were used to fund this prepay arrangement. The principal and interest on the bonds will be payable from MLGW's pledged revenues, which include all of MLGW's net revenues and certain other funds. The bonds are not obligations of TVA and are not secured by any TVA revenues or property. TVA received proceeds of $1.5 billion from this transaction in December 2003 and recorded these proceeds as unearned revenue in Energy prepayment obligations on the December 31, 2003, Balance Sheets. TVA recognizes revenue as electricity is delivered to customers based on the ratio of units of kilowatt-hours delivered to total units of kilowatt-hours under contract. For the three months ended December 31, 2003, over $15 million was recorded as revenue.

New Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board ("FASB") published Interpretation No. 46, *Consolidation of Variable Interest Entities*, which was revised by Interpretation No. 46R ("46R") in December 2003. This interpretation explains how to identify variable interest entities ("VIEs") and how an enterprise assesses its interests in a VIE to decide whether to consolidate that entity. It also clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The interpretation applies to nonpublic enterprises, and it becomes effective for TVA beginning October 1, 2005, for VIEs created on or before December 31, 2003, and immediately for VIEs created after December 31, 2003. At this time, TVA is in the process of evaluating the requirements of this interpretation and does not yet know the impact of its implementation, which may or may not be material to its results of operations or financial position.

Project Cancellation

In December 2003, TVA was notified that Regenesys Technologies Limited ("RTL") would not go forward with manufacturing of the fuel cells to be installed in the partially completed Regenesys energy storage plant in Columbus, Mississippi. RTL has made a business decision to close down all of its operations, making it impractical for TVA to complete the facility. After an evaluation of the project, TVA determined there were no other technologies that could be installed or other uses the facility could serve for the area. TVA had invested approximately $36 million on the Regenesys project which was included in Construction in progress on the Balance Sheet and, accordingly, recognized a $36 million loss during the first quarter of 2004. TVA anticipates reimbursement from RTL for early termination of the contract in the amount of $15 million, which, if received, will reduce the loss to $21 million on the cancellation of the Regenesys project.

Other

Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation.

2. Proprietary Capital

Accumulated Other Comprehensive Loss

SFAS No. 130, *Reporting Comprehensive Income*, requires the disclosure of comprehensive income (loss) to reflect changes in capital that result from transactions and economic events from nonowner sources. The losses for the three months ended December 31, 2003, are due to market valuation adjustments for certain derivative instruments.

Total Other Comprehensive Income (Loss) Activity—Power Program
(in millions)

	2003	2002
Accumulated other comprehensive loss, September 30	$ (74)	$ (150)
Changes in fair value of interest rate swap	(3)	(3)
Changes in fair value of foreign currency swaps	18	(71)
Accumulated other comprehensive loss, December 31	$ (59)	$ (224)

3. Debt Securities

TVA issues power bonds pursuant to Section 15d of the TVA Act and pursuant to the Basic Tennessee Valley Authority Power Bond Resolution. Power bonds in each series must be further authorized by a supplemental resolution.

TVA's power bonds and other evidences of indebtedness are not obligations of the United States of America, and the United States of America does not guarantee the payment of the principal of or interest on any of TVA's power bonds or other evidences of indebtedness.

From October 1, 2003, to December 31, 2003, TVA issued $93 million of electronotes® with an average interest rate of 5.08 percent. During this period TVA redeemed $15 million of electronotes® carrying an interest rate of 5.70 percent. One issue of power bonds totaling $400 million with an interest rate of 5.00 percent matured.

The table below summarizes TVA's debt securities activity for the period from October 1, 2003, to December 31, 2003.

Activity October 1, 2003 to December 31, 2003
(in millions)

Redemptions/Maturities:	Date	Amount	Interest Rate
electronotes®	First Quarter 2004	$ 15	5.70%
1998 Series I	December 18, 2003	400	5.00%
		$ 415	
Issues:			
electronotes®	First Quarter 2004	$ 93	4.50%-5.63%

4. Risk Management Activities and Derivative Transactions

TVA is exposed to market risks, including changes in interest rates, foreign currency exchange rates, and certain commodity and equity market prices. To manage the volatility attributable to these exposures, TVA has entered into various nontrading derivative transactions, principally an interest rate swap agreement, foreign currency swap contracts, and option and swaption contracts.

The recorded amounts of these derivative financial instruments are as follows:

Mark-to-Market Values of Derivative Transactions
(in millions)

	Asset/(Liability) At December 31 2003	Asset/(Liability) At September 30 2003
Interest rate swap	$ 41	$ 42
Currency swaps:		
Deutschemark (DM1.5 billion)	(73)	(149)
Sterling (GBP200 million)	17	(9)
Sterling (GBP250 million)	81	44
Sterling (GBP150 million)	33	11
Swaptions:		
Call provision on $1 billion bond issue	(192)	(207)
Call provision on $476 million bond issue	(95)	(111)
Debt-embedded calls:		
Call provision on $1 billion bond issue	156	169
Call provision on $476 million bond issue	72	91
Coal contracts	116	45
Purchase power contracts	(61)	(50)

5. Debt, Commitments and Contingencies

The debt maturities and estimated commitments for TVA as of December 31, 2003 are as follows:

(in millions)	2004*	2005	2006	2007	2008	Thereafter	Total
Debt	$ 2,832	$ 2,000	$ 2,621	$ 977	$ 91	$ 14,850	$ 23,371
Leases	42	54	48	41	35	92	312
Lease/leaseback	101	85	85	85	89	1,384	1,829
Power purchase obligations	108	149	149	128	113	2,568	3,215
Other obligations	794	628	454	259	92	96	2,323
Fuel purchase obligations	960	602	344	212	211	314	2,643
Pension contribution	22	-	-	-	-	-	22
Total	$ 4,859	$ 3,518	$ 3,701	$ 1,702	$ 631	$ 19,304	$ 33,715

* Period January 1 – September 30, 2004

6. Legal Proceedings

On February 13, 2004, the United States Solicitor General, on behalf of the Environmental Protection Agency ("EPA"), filed a petition seeking Supreme Court review of a decision by the U.S. Court of Appeals for the Eleventh Circuit ("Eleventh Circuit") that held that EPA's enforcement order against TVA under the Clean Air Act ("CAA") was unconstitutional. In the fall of 1999, EPA commenced judicial or administrative actions against a number of utilities in the eastern United States, including TVA, alleging that they modified their coal-fired units without complying with the CAA's new source review ("NSR") requirements. EPA issued an administrative order directing TVA to put new source controls on 14 of its coal-fired units and evaluate whether more controls should be installed on other units. TVA challenged the validity of this order, and on June 24, 2003, the Eleventh Circuit issued its decision in the case. Although the Eleventh Circuit did not rule on the merits of the case, the court held that the procedure used by EPA against TVA was “unconstitutional” because it allowed EPA to decide that a regulated party like TVA has violated the law and is liable for severe penalties without ever allowing the regulated party to present evidence on whether the law was in fact violated. Stating that the Eleventh Circuit’s decision “strikes at the heart of EPA’s enforcement authority under the Clean Air Act,” the Solicitor General’s petition argues that the Supreme Court should review the Eleventh Circuit’s decision because its constitutional holding is based on “a mistaken construction” of the CAA provisions for EPA orders and because the Eleventh Circuit should have held that TVA’s petition for review could not be settled in a court of law because the petition presented only a dispute between two Executive Branch agencies. The Solicitor General’s petition also argues that the Eleventh Circuit erred in holding that TVA had independent litigating authority and was authorized to initiate a judicial review proceeding over the objection of the Attorney General. TVA's response to th Solicitor General's petition is due by the end of March 2004.

The outcome of this litigation is uncertain. It is not possible to predict with certainty what impact implementation of EPA’s order would have on TVA if EPA prevails on the merits. If EPA substantially prevails, TVA could be required to incur capital costs in excess of $3 billion by 2010 to 2012 to implement EPA’s order. Any additional controls that TVA could be required to install on units as a result of this matter, however, would also apply toward other reduction requirements that are anticipated under developing CAA regulatory programs. Thus, because of the other CAA program requirements, TVA would, in any event, likely have to incur a substantial portion of the costs that might result from the EPA enforcement action. TVA fully supports the need to further reduce emissions from coal-fired plants and seeks a resolution that will not put TVA customers and its region at a disadvantage.

The National Parks Conservation Association (“NPCA”) and the Sierra Club filed cases in two federal district courts in 2001 raising the same NSR allegations at TVA’s Bull Run Fossil Plant and Colbert Fossil Plant Unit 5 as were raised in the EPA proceeding found unconstitutional by the Eleventh Circuit. Both cases were stayed pending resolution of matters raised in the Eleventh Circuit NSR litigation discussed above, and the stays continue in effect.

Environmental groups are taking legal action against TVA, as well as against other utilities across the country, for allegedly violating opacity limits applicable to coal-fired plants.

- The Alabama Environmental Council and the Sierra Club filed a lawsuit in federal district court in Florence, Alabama, alleging that TVA violated CAA opacity limits applicable to Colbert Fossil Plant between July 1, 1997, and June 30, 2002. The groups seek a court order that could require TVA to incur substantial costs in addition to the costs TVA is already planning to incur for environmental controls, and to pay civil penalties of up to approximately $250 million. On February 20, 2003, the federal district court dismissed the claim against TVA for civil penalties. These groups are still seeking a court order (1) declaring TVA in violation of opacity limits and (2) requiring TVA to bring the Colbert plant into continuous compliance with these limits. This case had been set for trial in the fall of 2003. However, the case was reassigned to another district court judge, and the new judge has not set a trial date.

- On July 25, 2003, TVA received a notice of intent to sue from Our Children’s Earth Foundation (“OCE”). OCE alleges that TVA violated the NSR requirements of the CAA by undertaking major modifications of TVA’s Allen Unit 3, Bull Run, Cumberland Units 1 and 2, Kingston Units 6 and 8, John Sevier Unit 3, Paradise Units 1, 2, and 3, Shawnee Units 1 and 4, Colbert Unit 5, and Widows Creek Unit 5. OCE also alleges the CAA new source performance standards at Colbert Unit 5 and the operations at TVA’s Johnsonville Fossil Plant have not met the applicable opacity requirements. This notice does not allege a specific amount of damages. OCE’s allegations about Bull Run and Colbert Unit 5 are already the subject of litigation in federal district courts initiated by the NPCA and the Sierra Club. Both of these cases were stayed pending resolution of the matters raised in the Eleventh Circuit NSR litigation discussed above. OCE states in their notice that they intend to file suit anytime after 60 days from the date of their letter but they have not done so to date.

- The Sierra Club gave notice in a September 26, 2002, letter that it intends to sue TVA for violating CAA opacity limits applicable to the John Sevier and Kingston Fossil Plants. The notice claims that TVA violated opacity standards at the two plants from July 1, 1997, to the present. The alleged opacity violations substantially overlap those that were challenged in a lawsuit filed by the NPCA three years ago in federal court in Knoxville, Tennessee. TVA ultimately prevailed in that lawsuit.

On December 28, 2001, Bowater Incorporated and Bowater Newsprint South, Inc. (together, “Bowater”) filed a lawsuit against TVA in federal court in Knoxville challenging TVA’s charges for Economy Surplus Power (“ESP”) and Testing and Restart Power (“TRP”) for two Bowater plants. In its complaint, Bowater alleges that in violation of the contract provision which states that TVA will charge ESP and TRP customers based on TVA’s actual hourly incremental cost of providing ESP (1) TVA included certain alleged non-incremental costs in the prices for ESP and TRP and (2) when calculating such prices TVA used the cost of providing the most expensive 100 megawatts of ESP sold during a given hour instead of the average cost in that hour of serving the entire ESP load. The complaint also alleges that TVA has been unjustly enriched as a result of these overcharges. The lawsuit seeks, among other things, compensatory damages in excess of $39 million and interest of more than $15 million. The case is set for trial in January 2005.

On August 31, 1999, Birmingham Steel Corporation filed a lawsuit in the U.S. District Court for the Northern District of Alabama alleging that TVA overcharged for ESP during the summer of 1998. The lawsuit was filed as a class action on behalf of industrial customers who participated in TVA's ESP program. Under ESP contracts, the hourly ESP energy price is calculated using TVA's actual incremental cost of supplying the ESP load in each hour. The plaintiff alleges that TVA overcharged for ESP during the summer of 1998 by including in the price of ESP some costs that were added to TVA's incremental cost. The complaint seeks over $100 million in damages on behalf of Birmingham Steel and the other class members. In September 2002, the district court decertified the class and then dismissed Birmingham Steel's individual claim without prejudice on a jurisdictional issue. The class lawyers appealed the ruling on class decertification, and in December 2003, the U.S. Court of Appeals for the Eleventh Circuit reversed that ruling and sent the case back to the district court to allow the class lawyers a reasonable time to find a new class representative. The district court has issued an order giving the class lawyers until mid May to find a new class representative. If the class lawyers are unsuccessful, the Eleventh Circuit indicated that the class could then be decertified. At the present time, TVA believes it is more likely than not that a new class representative will not come forward.

TVA is a party to various other civil lawsuits and claims that have arisen in the ordinary course of its business. Although the outcome of these other civil lawsuits and claims cannot be predicted with any certainty, it is the opinion of TVA counsel that their ultimate outcome should not have a materially adverse effect on TVA's financial position or results of operations.

7. Stewardship Responsibilities

During the first quarter of 2004, TVA continued to conduct certain nonpower programs including managing navigable river channels, providing flood control, and overseeing certain recreation facilities. TVA's responsibilities include general stewardship of land, water, and wildlife resources. Historically, Congressional appropriations provided most of the funding for TVA's nonpower programs, and TVA has obtained additional funds from revenues and user fees from the nonpower programs. In October 1997, Congress passed legislation that directed TVA to fund essential stewardship activities from various funds, including power funds, in the event that there were insufficient appropriations or other available funds to pay for such activities in any year. Beginning in 2000, Congress stopped providing appropriations to TVA to fund essential stewardship activities. TVA primarily is using power funds (along with user fees and other forms of nonpower revenues) to continue to fund these stewardship activities. TVA spent a total of approximately $17 million of power funds on essential stewardship activities during the first three months of fiscal year 2004.

8. Subsequent Events

Legislation

In early February 2004, the Bush Administration released its fiscal year 2005 budget plan. Among other things, the plan establishes annual debt reduction targets for TVA and states that the Administration intends to propose legislation that would count financial transactions, such as lease-leaseback obligations, that result in increasing TVA's long-term liabilities towards TVA's $30 billion debt ceiling.

On February 12, 2004, Senate Energy and Natural Resources Committee Chairman, Pete V. Domenici, R-NM, introduced a new "slimmed down" national energy policy bill, S. 2095 ("S. 2095"). Although "slimmed down," S. 2095 contains the same provisions with respect to TVA as were included in the energy bill that came out of the Conference Committee, but did not become law, in the last session of Congress.

Among other things, S. 2095 would (1) convert TVA's Board of Directors into a part-time Board of nine members serving sequenced five-year terms and create a new position of Chief Executive Officer to manage TVA's day-to-day operations, (2) authorize FERC to review TVA's transmission rates and terms and conditions of service to determine whether they are comparable to those TVA imposes on itself and whether they are unduly discriminatory, and (3) authorize FERC to order refunds if the rates charged by TVA and other nonjurisdictional entities on wholesale electricity transactions for a term of 31 days or less are not just and reasonable. In addition, S. 2095 contains some unclear language that might be interpreted as inadvertently repealing the Anti-Cherrypicking Provision (as defined in the 2003 Information Statement in "Management's Discussion and Analysis of Financial Condition and Results of Operations" — "TVA and Competition"). TVA does not believe that this provision of S. 2095 was included with the intention of repealing the Anti-Cherrypicking Provision and will work to obtain an appropriate modification or a floor colloquy stating that no such repeal was intended.

S. 2095 was introduced under a rule which provides that the bill will be immediately placed on the Senate calendar where it can be brought to the Senate floor for consideration without first having to go through a committee.

Management

On February 13, 2004, John Scalice, Chief Nuclear Officer and Executive Vice President, TVA Nuclear, announced that he will retire from TVA effective June 1, 2004. Karl Singer, who currently is serving as Senior Vice President, Nuclear Operations, will assume the position of Chief Nuclear Officer and Executive Vice President, TVA Nuclear, on June 1, 2004.

On March 3, 2004, Mark Medford, Executive Vice President Customer Service and Marketing, announced that he will retire from TVA effective December 2004. He will work actively with the Board and his successor to ensure a smooth transition during the next few months.

Debt Securities

In February 2004, TVA redeemed all of its 2002 5.5 percent electronotes® due February 15, 2012, with a par amount of $30 million. TVA also redeemed all of its 2000 Series C 7.50 percent and 2000 Series D 7.65 percent Quarterly Income Tiered Securities in February 2004. The 2000 Series C bonds had a par amount of $25 million and were due February 18, 2015. The 2000 Series D bonds had a par amount of $25 million and were due February 18, 2020.

On March 4, 2004, TVA issued an additional $550 million aggregate principal amount of its 6.79 percent Power Bonds 2002 Series A due May 23, 2012. The total offering now stands at approximately $1.5 billion. The additional bonds were priced to yield 4.22 percent to TVA with proceeds of $647.5 million. The purchasers of the bonds have the option of putting the bond back to TVA at par on May 24, 2004.

Call Monetization

In the fourth quarter of 2003, TVA monetized the call option on a public bond issue by entering into a swaption transaction (see Monetization of Call Options on page 31 of the 2003 Information Statement). In February 2004, the counterparty to the swaption transaction exercised its option to enter into a swap with TVA where TVA will be required to make fixed rate payments to the counterparty of 6.875 percent and the counterparty will be required to make floating payments based on London Interbank Offered Rate ("LIBOR"). These payments will be based on a notional principal amount of $476.5 million, and the parties will begin making these payments on June 15, 2004. On March 9, 2004, TVA provided notice that it will call on April 10, 2004, all of its outstanding 6.875 percent 1993 Series F Power Bonds.

Strategic Plan Implementation

As part of its strategic plan, TVA is striving to enhance its financial flexibility by reducing debt and other fixed costs. TVA expects a substantial portion of the necessary budget reductions to come from (1) reductions in capital projects, with resulting reductions in spending for materials and contractors, (2) reductions in contractors supporting ongoing work, and (3) a methodical review of all TVA programs and functions, including staffing levels. To this end, organizations within TVA are performing program and staffing reviews to identify surplus staffing situations. In areas where surplus staffing exists, TVA has asked for employees to apply for voluntary resignations during February and March of 2004. To the extent there are not enough volunteers, TVA will conduct an involuntary Reduction in Force ("RIF"). TVA expects the majority of voluntary resignations and involuntary RIFs to occur in 2004. It is anticipated that between 600 to 800 people will be affected by the change in staffing levels. Implementation of the change in staffing levels is estimated to cost between $27 million and $36 million.

Additionally, TVA has reviewed its capital projects and has identified $247 million in capital expenditure reductions for 2005. The plan also recommends a debt-reduction target of $3 billion to $5 billion over the next ten to 12 years but notes that debt-reduction targets will be updated annually depending on TVA's priorities and changing market conditions.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") explains the results of operations and general financial condition of TVA. The MD&A should be read in conjunction with the accompanying Financial Statements and the 2003 Information Statement.

Results of Operations

Net income for the first quarter was $70 million, a decrease of $244 million compared with the first quarter of 2003. A significant portion of the decrease relates to two noncash accounting changes implemented during the first quarter of 2003. These included a $412 million gain related to a change in accounting for unbilled revenue and a $195 million charge related to a change in accounting for asset retirement obligations.

Operating Revenues. Total sales of electricity increased 438 million kilowatt-hours, or one percent. The slight decrease in sales to municipalities and cooperatives was primarily weather related with ten percent fewer heating degree days and 45 percent fewer cooling degree days in the first quarter of 2004 as compared to the first quarter of the prior year, partially offset by an increase in economic growth. The increase in sales to industries directly served is attributable to improved economic conditions and business activity for certain industrial customers. A detailed table of electricity sales for the three month periods ended December 31, 2003, and 2002 is as follows:

	Three months ended December 31		
(millions of kWh)	2003	2002	Percent Change
Sales of electricity			
Municipalities and cooperatives	30,787	30,884	(0.3%)
Industries directly served	7,687	7,243	6.1%
Federal agencies and other	982	891	10.2%
Total sales of electricity	39,456	39,018	1.1%

Total operating revenues were $1,777 million in the quarter ended December 31, 2003, compared with $1,682 million in the quarter ended December 31, 2002, an increase of nearly six percent. A detailed table of operating revenue for the three month periods is as follows:

	Three months ended December 31		
(in millions)	2003	2002	Percent Change
Operating revenues			
Sales of electricity			
Municipalities and cooperatives	$ 1,521	$ 1,446	5.2%
Industries directly served	198	186	6.5%
Federal agencies and other	37	31	19.4%
Other revenue	21	19	10.5%
Total operating revenues	$ 1,777	$ 1,682	5.6%

Effective with the October 2003 wholesale billing months, previously Board approved rate actions were implemented. The rate actions are expected to result in a 7.4 percent increase in wholesale rates for resale to residential and non-manufacturing loads and a two percent decrease in wholesale rates for resale to large manufacturers. Corresponding changes and adjustments were approved for distributor resale rates and for TVA's rates to directly served customers.

The increase in total operating revenues for the three month period ended December 31, 2003, over the same period in 2002 resulted mainly from the increase in TVA's electric rates discussed above. Although kilowatt-hour sales to municipalities and cooperatives decreased slightly from 2003 to 2004, the increase in revenue from municipalities and cooperatives of $75 million, or five percent, reflects the higher rates as compared to the prior year. Revenues from industries directly served increased $12 million, or six percent, primarily due to increased volume of 444 million kilowatt-hours, or six percent, in comparison with the prior year.

Fuel and Purchased Power. Fuel and purchased power expense was $430 million for the quarter ended December 31, 2003, compared with $409 million for the quarter ended December 31, 2002, an increase of $21 million or five percent. Fuel costs increased $7 million or two percent due to increased fossil generation. Purchased power costs increased $14 million, or 26 percent, due mainly to increased off system purchases. Market prices have been consistently higher reflecting an increase in the average rate for interchange power received.

Operating and Maintenance Expenses. Operating and Maintenance ("O&M") costs increased $68 million, or 14 percent, from $488 million to $556 million for the quarters ended December 31, 2002, and 2003, respectively. O&M costs related to projects at fossil units increased $7 million. Other O&M costs increased $60 million primarily due to higher benefit costs of $7 million, increased workers compensation costs of $3 million, increased payroll costs for the month of December of $7 million, increased pension expense of $28 million, additional combustion turbine financing costs of $3 million, financing costs for certain qualified technological equipment of $4 million, and an increase in provisions for inventory obsolescence of $4 million.

Depreciation and Accretion. Depreciation and accretion increased $9 million from the same period last year due to increased depreciation expense of $9 million for capital projects placed in service during the year.

Project Cancellation. In December 2003, TVA was notified that Regenesys Technologies Limited ("RTL") would not go forward with manufacturing of the fuel cells to be installed in the partially completed Regenesys energy storage plant in Columbus, Mississippi. TVA had invested approximately $36 million on the Regenesys project and, accordingly, TVA has recognized a $36 million loss on the cancellation of the Regenesys project. (See note 1 — *Project Cancellation*).

Other Income. TVA had net other income of $4 million in the first quarter fiscal year 2004 compared with net other income of $3 million in the same period last year. The slight increase in net other income relates to an increase in non-electric business activity.

Interest Expense. Interest expense was $333 million for the quarter ended December 31, 2003, compared with $346 million in the quarter ended December 31, 2002. This reduction reflects lower average interest rates for long-term and short-term debt and a lower level of total outstanding debt during the first quarter of fiscal year 2004. Total outstanding indebtedness, excluding discounts and premiums, as of December 31, 2003, was $23.4 billion with a blended average interest rate of 5.96 percent (of long-term and short-term debt); as of December 31, 2002, total outstanding indebtedness, excluding discounts and premiums, was $24.9 billion with a blended average interest rate of 5.79 percent (of long-term and short-term debt). The average long-term and short-term interest rates for the quarter ended December 31, 2003, were 6.23 percent and 1.00 percent, respectively, compared with 6.39 percent and 1.55 percent for the same quarter of 2002.

Cumulative Effects of Accounting Changes. The net gain of $217 million from accounting changes during the first quarter of 2003 resulted from a gain related to a change in accounting for unbilled revenues of $412 million, partially offset by a charge related to a change in accounting for asset retirement obligations of $195 million.

Material Changes in Liquidity and Capital Resources

Comparative Cash Flow Analysis - Power Program

Net cash provided by operating activities increased $1,357 million from $278 million to $1,635 million for the three month periods ending December 31, 2002, and 2003, respectively. The increase reflects higher operating revenues of $95 million. Cash outlays for interest declined $5 million and other items requiring cash increased $48 million primarily due to increased deferred outage activity. Proceeds from energy prepayments increased $1,472 million. Other changes included increased cash outlays for O&M costs of $30 million and increased cash paid for purchased power of $25 million. Cash used for working capital components increased $85 million, from $163 million in 2002 to $248 million in 2003. This increase resulted from a smaller reduction of accounts receivable of $115 million and a larger reduction of accounts payable and accrued liabilities of $14 million, partially offset by a smaller reduction of accrued interest of $16 million and a $7 million decrease in inventories and other assets in 2003 compared with a $21 million increase in inventories and other assets in 2002.

Cash used in investing activities decreased $88 million primarily due to decreased expenditures for capital projects of $11 million and a decrease in fabrication of nuclear fuel of $68 million due to timing of enrichment services received.

Net cash used in financing activities was $1,520 million for the three months ended December 31, 2003, compared with net cash provided by financing activities of $35 million for the same period of 2002. This change is primarily related to the use of the $1.5 billion in proceeds received from energy prepayments to reduce outstanding debt during the first quarter of 2004. Long-term debt issues decreased $63 million and redemptions of long-term debt increased $415 million. Net redemptions of short term debt increased $924 million compared to the prior year. There were no proceeds received from combustion turbine financing in the current year compared to $163 million in the prior year.

Comparative Cash Flow Analysis-All Programs
The Statements of Cash Flows-All Programs are substantially the same as the Statements of Cash Flows-Power Program and should be viewed in conjunction with the Comparative Cash Flow Analysis-Power Program and the Statements of Cash Flows-Power Program.

Working Capital
At December 31, 2003, TVA had negative working capital of nearly $2,368 million, largely attributable to current maturities of long-term debt of $1,936 million and short-term indebtedness of $896 million. The table below summarizes the components of working capital. It is TVA's cash management policy to use short term notes to meet current obligations, and TVA will continue to use such financing instruments as long as short-term interest rates remain favorable and interest coverage levels are met.

	Power Program		All Programs	
(in millions)	December 31 2003	September 30 2003	December 31 2003	September 30 2003
Current assets	$ 1,748	$ 2,053	$ 1,749	$ 2,054
Current liabilities	4,116	5,901	4,117	5,902
Working capital	$ (2,368)	$ (3,848)	$ (2,368)	$ (3,848)
Discount notes <90 days	$ 896	$ 2,080	$ 896	$ 2,080
Current maturities of long-term debt	1,936	2,336	1,936	2,336
Total short-term debt	$ 2,832	$ 4,416	$ 2,832	$ 4,416

Financing Activities
Capital Resources
From October 1, 2003 to December 31, 2003, TVA issued $93 million of electronotes® with an average interest rate of 5.08 percent. During this period, TVA redeemed $15 million of electronotes® carrying an interest rate of 5.70 percent. One bond issue totaling $400 million with an interest rate of 5.00 percent matured. TVA also issued discount notes of nearly $5 billion while redeeming $6.1 billion of notes. The average interest rate on the discount notes was one percent.

Energy Prepayment Obligations
During October of 2002, TVA introduced the Discounted Energy Units ("DEU") program as another way of providing value to its customers. Annually for fiscal years 2003-2007, TVA customers may purchase DEU in $1 million increments, which entitles them to a 0.025 $/kWh discount on a specified quantity of firm load for a specified term. The remainder of the price of the kilowatt-hours delivered is due upon billing. This program allows customers to use the DEU to reduce their overall costs and provides a higher return for available cash.

As of December 31, 2003, TVA had entered into sales agreements for 47.25 DEU totaling $47.25 million for the 2003 program and sales agreements for 7.25 DEU totaling $7.25 million for the 2004 program. TVA is accounting for this as unearned revenue in Energy prepayment obligations on the December 31, 2003, Balance Sheets and is recognizing revenue as electricity is delivered to customers, based on the ratio of units of kilowatt-hours delivered to total units of kilowatt-hours under contract. As of December 31, 2003, nearly $5 million has been applied against power billings, of which $1.3 million is attributable to 2004 activity.

TVA and its largest customer, Memphis, Light, Gas & Water ("MLGW"), entered into an agreement where MLGW prepaid TVA $1.5 billion for the costs of electricity to be delivered by TVA to MLGW over a period of 180 months. In exchange for this prepayment, MLGW receives a credit on its monthly bills during this period. The City of Memphis issued bonds with net proceeds of $1.5 billion, the proceeds of which were used to fund this prepay arrangement. The principal and interest on the bonds will be payable from MLGW's pledged revenues, which include all of MLGW's net revenues and certain other funds. The bonds are not obligations of TVA and are not secured by any TVA revenues or property. TVA received proceeds of $1.5 billion from this transaction in December 2003 and recorded these proceeds as unearned revenue in Energy prepayment obligations on the December 31, 2003, Balance Sheets. TVA recognizes revenue as electricity is delivered to customers based on the ratio of units of kilowatt-hours delivered to total units of kilowatt-hours under contract. For the three months ended December 31, 2003, over $15 million was recorded as revenue.

Cash Requirements and Contractual Obligations
TVA's debt and estimated commitments as of December 31, 2003 are as follows:

(in millions)

	2004*	2005	2006	2007	2008	Thereafter	Total
Debt	$ 2,832	$ 2,000	$ 2,621	$ 977	$ 91	$ 14,850	$ 23,371
Leases	42	54	48	41	35	92	312
Lease/leaseback	101	85	85	85	89	1,384	1,829
Power purchase obligations	108	149	149	128	113	2,568	3,215
Other obligations	794	628	454	259	92	96	2,323
Fuel purchase obligations	960	602	344	212	211	314	2,643
Pension contribution	22	-	-	-	-	-	22
Total	$ 4,859	$ 3,518	$ 3,701	$ 1,702	$ 631	$ 19,304	$ 33,715

* Period January 1- September 30, 2004

As of December 31, 2003, the decommissioning trust funds totaled approximately $710 million. The present value of the estimated future decommissioning costs calculated in accordance with Nuclear Regulatory Commission ("NRC") requirements is $903 million. In October of 2003, TVA submitted a supplemental decommissioning funding status report to the NRC. The report contained a yearly schedule of projected decommissioning trust fund balances which provides assurance that adequate funds will be available to decommission the nuclear plants when necessary. TVA will make contributions to the trust fund or provide other methods of funding assurance if necessary to match its schedule of projected decommissioning fund balances. TVA's decommissioning fund met the 2003 funding target of approximately $606 million.

Strategic Plan Implementation
To prepare for a more competitive electricity market, TVA has implemented a strategic planning process that analyzes how the new market may function, what competitive pressures TVA will face, and how TVA must prepare now for success in the future. More specifically, the process focuses on what TVA needs to do in order to preserve TVA's core mission to provide low-cost power, promote economic prosperity in the Valley, and enhance environmental stewardship and to remain financially viable in a competitive market.

As part of this strategic plan, TVA is striving to enhance its financial flexibility by reducing debt and other fixed costs. TVA expects a substantial portion of the necessary budget reductions to come from (1) reductions in capital projects, with resulting reductions in spending for materials and contractors, (2) reductions in contractors supporting ongoing work, and (3) a methodical review of all TVA programs and functions, including staffing levels. To this end, organizations within TVA are performing program and staffing reviews to identify surplus staffing situations. In areas where surplus staffing exists, TVA has asked for employees to apply for voluntary resignations during February and March of 2004. To the extent there are not enough volunteers, TVA will conduct an involuntary Reduction in Force ("RIF"). TVA expects the majority of voluntary resignations and involuntary RIFs to occur in 2004. It is anticipated that between 600 to 800 people will be affected by the change in staffing levels. Implementation of the change in staffing levels is estimated to cost between $27 million and $36 million.

Additionally, TVA has reviewed its capital projects and has identified $247 million in capital expenditure reductions for 2005. The plan also recommends a debt-reduction target of $3 billion to $5 billion over the next ten to 12 years but notes that debt-reduction targets will be updated annually depending on TVA's priorities and changing market conditions.

New Accounting Pronouncements
In January 2003, the Financial Accounting Standards Board ("FASB") published Interpretation No. 46, *Consolidation of Variable Interest Entities*, which was revised by Interpretation No. 46R ("46R") in December 2003. This interpretation explains how to identify variable interest entities ("VIEs") and how an enterprise assesses its interests in a VIE to decide whether to consolidate that entity. It also clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The interpretation applies to nonpublic enterprises, and it becomes effective for TVA beginning October 1, 2005, for VIEs created on or before December 31, 2003, and immediately for VIEs created after December 31, 2003. At this time, TVA is in the process of evaluating the requirements of this interpretation and does not yet know the impact of its implementation, which may or may not be material to TVA's results of operations or financial position.

QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

General

TVA's Risk Management Committee is charged with the responsibility of reviewing and approving controls and procedures for TVA-wide risk management activities, including the oversight of models and assumptions used to measure risk, the review of counterparty exposure limits, and the establishment of formal procedures regarding the use of financial hedging instruments.

Through the normal course of its business, TVA is exposed to various market risks, including changes in interest rates, foreign currency exchange rates, and certain commodity and equity market prices. TVA is also exposed to losses in the event of counterparties' nonperformance and accordingly has established controls to determine the creditworthiness of counterparties in order to mitigate exposure to credit risk.

Derivatives

To manage the volatility attributable to its various risk exposures, TVA has entered into various nontrading derivative transactions. TVA risk management policies provide for the use of derivative financial instruments to manage financial exposures but prohibit the use of these instruments for speculative or trading purposes. TVA accounts for these derivative instruments in accordance with the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, and SFAS No. 149, A*mendment of Statement 133 on Derivative Instruments and Hedging Activities*.

Certain derivative contracts utilized by TVA consist of currency and interest rate swap agreements. These currency and interest rate swap agreements qualify for cash flow hedge accounting treatment under SFAS No. 133. Consequently, the effective portions of gains and losses related to these types of contracts are deferred and reported in Accumulated other comprehensive loss with corresponding adjustments to the derivatives' book values until the contracts actually settle. The ineffective portions of the derivatives' changes in fair value are recognized immediately in the determination of earnings.

Other derivative contracts include various purchased power option contracts, coal and natural gas contracts, certain swaption agreements, and purchased options related to SO_2 allowances. Hedges entered into in conjunction with these contracts qualify for fair value hedge accounting under SFAS Nos. 133 and 138 with changes in market values deferred and recognized as regulatory assets and/or liabilities in accordance with SFAS No. 71. Such treatment reflects TVA's ability and intent to account for these derivative instruments on a settlement basis for rate-making purposes. The ineffective portions of the derivatives' change in fair value are recognized immediately in the determination of earnings.

Financial Trading Pilot Program

A financial trading pilot program to reduce TVA's economic risk exposure associated with TVA's physical electric generation, purchases, and sales was approved by the Board on September 11, 2003. The program allows TVA to trade certain futures contracts and options on futures for hedging purposes only. Trading covered by this authorization will be for the purpose of hedging risks associated with the cost of natural gas and fuel oil for TVA's power generation operations and risks under power purchase or sales arrangements where the energy price varies based upon a fuel index. Trading of authorized futures contracts and options on futures contracts shall be limited solely to those transactions that hedge or otherwise limit economic risks directly associated with TVA's fuel requirements for power generation or with the aforementioned type of power purchase or sale arrangement. Transactions shall be limited to trading of the NYMEX futures contracts and options on futures contracts related to natural gas and fuel oil. Trading is not authorized for speculative purposes. The pilot program extends through August 31, 2005. There were no trades in 2003 or in the first quarter of 2004 which ended December 31, 2003.

CONTROLS AND PROCEDURES

TVA's management, including the Chief Financial Officer ("CFO") and the members of the Board, have conducted an evaluation of the effectiveness of TVA's disclosure controls and procedures as of the end of the period covered by this Quarterly Report. Based on that evaluation, the members of the Board and CFO concluded that the disclosure controls and procedures are effective in providing reasonable assurance that all material information necessary and appropriate in this Quarterly Report has been made known to them in a timely fashion. TVA's disclosure controls and procedures are effective in providing reasonable assurance that information to be disclosed in TVA's reports is accumulated and communicated to management, including the members of the Board and the CFO, as appropriate, to allow timely decisions regarding disclosure. There have been no significant changes in internal control over financial reporting during the quarter ended December 31, 2003, that have materially affected, or are reasonably likely to materially affect, TVA's internal control over financial reporting.

TVA management believes that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company can be detected. TVA's controls and procedures can only provide reasonable, not absolute, assurance that the above objectives will be met.

It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

OTHER INFORMATION

BOARD ACTIONS

As of October 6, 2003, the Board had not vetoed amendments to the rules and regulations of the TVA Retirement System ("Rules") and to the provisions of the TVA Savings and Deferral Retirement Plan ("401(k) Plan"), to provide that certain TVA lump-sum compensation paid to employees for fiscal year 2004 would be credited for the purposes of calculating pension benefits under the Rules and TVA matching contributions under the provisions of the 401(k) Plan.

On November 5, 2003, the Board approved a prepayment arrangement involving a $1.5 billion prepayment to TVA by the Memphis Light, Gas and Water for a portion of its power costs over a 15 year period.

As of January 28, 2004, the Board approved the 2003 Information Statement and Summary Analysis of Results of Operations and Financial Condition contained in the 2003 Annual Report.

ADDITIONAL INFORMATION

Regulatory Actions
The Nuclear Regulatory Commission ("NRC") issued a series of Advisories and Orders to further strengthen security at NRC-licensed facilities and increase the controls placed on nuclear materials. The nuclear energy industry, including TVA, has increased security spending to implement these additional security measures. Compliance with these additional measures could require significant expenditures by TVA and the nuclear power industry over the next several years.

Customers
Contract Termination Notices
In November 2003, TVA received notice from Monticello Plant Board ("Monticello") that terminates its power contract with TVA in November 2008. In 2003, sales to Monticello generated less that 0.1 percent of TVA's electricity sales.

In December 2003, TVA received notice from Glasgow Electric Plant Board ("Glasgow") that terminates its power contract with TVA in December 2008. In 2003, sales to Glasgow generated approximately 0.2 percent of TVA's electricity sales.

USEC Contract
In January 2004, the United States Enrichment Corporation ("USEC") announced it will begin constructing its new commercial centrifuge facility in Piketon, Ohio. Once this new facility is opened, it is unclear how much energy USEC will need to acquire from TVA for its Paducah, Kentucky facility ("Paducah Facility"). Under the current contract with TVA, USEC is required to purchase a fixed amount of energy for its Paducah Facility through May 2006. In 2003, sales to USEC for its Paducah Facility generated approximately 3.5 percent of TVA's total operating revenues.

Operations
Outages
Following the installation of a major scrubber modification, Widows Creek Fossil Plant Unit 8, which has a net dependable capacity rating of 471 megawatts, did not meet applicable opacity limits. The installation of this modification was completed on December 30, 2003, and shortly thereafter this opacity problem was discovered. TVA will continue to work with the State of Alabama to determine the conditions under which TVA will operate the unit other than for testing purposes until it is in compliance with the applicable opacity limits. TVA is in the process of determining the cause and corrective actions for the opacity problem at this unit.

Browns Ferry Unit 1
In May 2002, the TVA Board initiated activities for the return of Browns Ferry Unit 1 to service in order to meet long-term energy needs in the Tennessee Valley. It is anticipated the Browns Ferry Unit 1 recovery project will add approximately 1,280 megawatts of generation at a cost of approximately $1.8 billion. Unit 1 is expected to return to service in 2007, and the additional generating capacity is expected to lower the average cost of power and provide additional cash flow. As of December 31, 2003, TVA had incurred approximately $531 million of costs on the Browns Ferry Unit 1 restart project, the planned amount for this period. The restart project was about 38 percent complete at that date.

CERTIFICATIONS OF THE MEMBERS OF THE TVA BOARD OF DIRECTORS

Glenn L. McCullough, Jr., Skila Harris, and Bill Baxter individually certify that:

1. I have reviewed the Tennessee Valley Authority Quarterly Report ("Report") for the quarterly period ended December 31, 2003;

2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this Report;

3. Based on my knowledge, the unaudited financial statements and other financial information included in this Report fairly present in all material respects the financial condition, results of operations, and cash flows of the Tennessee Valley Authority as of, and for, the periods presented in this Report;

4. The other certifiers and I are responsible for establishing and maintaining disclosure controls and procedures for the Tennessee Valley Authority and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Tennessee Valley Authority is made known to us by others particularly during the period in which this Report is being prepared;

b) evaluated the effectiveness of the Tennessee Valley Authority's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and

c) disclosed in this Report any change in internal control over financial reporting that occurred during the quarter ended December 31, 2003 that has materially affected, or is reasonably likely to materially affect, the Tennessee Valley Authority's internal control over financial reporting; and

5. The other certifiers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Tennessee Valley Authority's auditors and the Inspector General of the Tennessee Valley Authority:

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Tennessee Valley Authority's ability to record, process, summarize, and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Tennessee Valley Authority's internal control over financial reporting.

Date: March 17, 2004

Glenn L. McCullough, Jr.
Chairman

Skila Harris
Director

Bill Baxter
Director

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER

I, Michael E. Rescoe, certify that:

1. I have reviewed the Tennessee Valley Authority Quarterly Report ("Report") for the quarterly period ended December 31, 2003;

2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this Report;

3. Based on my knowledge, the unaudited financial statements and other financial information included in this Report fairly present in all material respects the financial condition, results of operations, and cash flows of the Tennessee Valley Authority as of, and for, the periods presented in this Report;

4. The other certifiers and I are responsible for establishing and maintaining disclosure controls and procedures for the Tennessee Valley Authority and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Tennessee Valley Authority is made known to us by others particularly during the period in which this Report is being prepared;

b) evaluated the effectiveness of the Tennessee Valley Authority's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and

c) disclosed in this Report any change in internal control over financial reporting that occurred during the quarter ended December 31, 2003 that has materially affected, or is reasonably likely to materially affect, the Tennessee Valley Authority's internal control over financial reporting; and

5. The other certifiers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Tennessee Valley Authority's auditors and the Inspector General of the Tennessee Valley Authority:

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Tennessee Valley Authority's ability to record, process, summarize, and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Tennessee Valley Authority's internal control over financial reporting.

Date: March 12, 2004

Michael E. Rescoe
Chief Financial Officer and Executive Vice President, Financial Services

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E-mail Alert

E-mail alerts are messages that are delivered to a subscriber's e-mail address whenever certain new information is posted to TVA's Investor Resources web pages. To subscribe to e-mail alerts, visit TVA's web site at: www.tva.com/finance

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